



SCHOOL OF LAW
TEXAS A&M UNIVERSITY

Texas A&M University School of Law
Texas A&M Law Scholarship

Faculty Scholarship

9-2014

Using the Theories of Exit, Voice, Loyalty, and Procedural Justice to Reconceptualize Brazil's Rejection of Bilateral Investment Treaties

Nancy A. Welsh

Texas A&M University School of Law, nwelsh@law.tamu.edu

Andrea Kupfer Schneider

Marquette University

Kathryn Rimpfel

Follow this and additional works at: <https://scholarship.law.tamu.edu/facscholar>



Part of the [Dispute Resolution and Arbitration Commons](#), and the [International Law Commons](#)

Recommended Citation

Nancy A. Welsh, Andrea K. Schneider & Kathryn Rimpfel, *Using the Theories of Exit, Voice, Loyalty, and Procedural Justice to Reconceptualize Brazil's Rejection of Bilateral Investment Treaties*, 45 Wash. U.J.L. & Pol'y 105 (2014).

Available at: <https://scholarship.law.tamu.edu/facscholar/944>

This Article is brought to you for free and open access by Texas A&M Law Scholarship. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of Texas A&M Law Scholarship. For more information, please contact aretteen@law.tamu.edu.

Using the Theories of Exit, Voice, Loyalty, and Procedural Justice to Reconceptualize Brazil's Rejection of Bilateral Investment Treaties

Nancy A. Welsh
Andrea Kupfer Schneider
Kathryn Rimpfel*

I. INTRODUCTION

In the past decade, investor-state arbitration has made tremendous gains in both credibility and use. There is now widespread accession to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (“ICSID Convention” or “Washington Convention”).¹ States have executed more than 2,000 bilateral investment treaties (BITs) defining the terms and conditions under which one (“investor”) state’s nationals and companies will invest in the other (“host”) state.² Such terms include provisions allowing foreign investors to initiate arbitration proceedings against the host state, and at this point, more than 500 disputes have been

* Nancy A. Welsh, William Trickett Faculty Scholar and Professor of Law, Penn State University, Dickinson School of Law; Andrea Kupfer Schneider, Professor of Law and Director, Dispute Resolution Program, Marquette University Law School; Kathryn Rimpfel, J.D. (2014), Penn State University, Dickinson School of Law. The authors thank the participants of the Washington University School of Law Global Dispute Resolution Scholarship Roundtable for their insightful comments. Any errors or omissions are, of course, our own.

1. “There are currently 158 signatory States to the ICSID Convention.” *Member States*, INT’L CTR. FOR THE SETTLEMENT OF INV. DISPS., https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=MemberStates_Home (last visited Nov. 2, 2013).

2. *Bilateral Investment Treaties*, LEGAL INFO. INST., http://www.law.cornell.edu/wex/bilateral_investment_treaty (last visited Apr. 5, 2014). The U.N. Conference on Trade & Development (UNCTAD) reported 2,495 bilateral investment treaties as of 2005. U.N. CONF. ON TRADE & DEV., WORLD INV. REPORT 2006, FDI FROM DEV. & TRANSITION ECONS.: IMPLICATIONS FOR DEV., at xix, U.N. Sales No. E.06.IID.11 (July 2006).

submitted to investor-state arbitration.³ There is, however, one very notable example of a rapidly developing state that has rejected this system of international dispute resolution in favor of nation-level structures. That example is the largely industrialized state of Brazil.

Brazil boasts the seventh largest economy in the world,⁴ \$65 billion in foreign direct investment,⁵ and enticing investment opportunities in advance of its hosting of the 2014 World Cup and 2016 Olympic Games. But Brazil does not have a single BIT in force.⁶ Brazil's notorious absence from international investment arbitration has been described as the product of the region's recent economic history, coupled with technical and political barriers that have impeded the ratification of BITs in particular. Some commentators have also found that Brazil's failure to enact BITs and its general avoidance of international forums for dispute resolution are largely the result of shifting priorities on the part of the executive branch of the Brazilian government, as will be discussed in Part III, *infra*.

Those who are most interested in international investment arbitration often present Brazil's choice not to ratify its BITs as problematic and, indeed, as a failure. This label, however, is only used by certain audiences in assessing Brazil's actions.⁷ Using Hirschman's theory of exit, voice, and loyalty—supplemented by procedural justice research and theory—a different conclusion emerges. The failure of Brazil's executive and legislative branches to reach agreement on BITs represents a story of Brazilian legislators' exit from the product that had been negotiated by the state's diplomats. But this exit also evidences the executive's

3. *International Investment Disputes Hit Record in 2012*, UN NEWS CTR. (Apr. 10, 2013), <http://www.un.org/apps/news/story.asp?NewsID=44616#.Uwj7Df0wwds>.

4. Ben Tavener, *Brazil Slides to 7th World Economy*, RIO TIMES (Mar. 4, 2013), <http://riotimesonline.com/brazil-news/rio-business/brazil-slides-to-7th-world-economy/>.

5. ORG. ECON. COOP. & DEV., FDI IN FIGURES (Apr. 2013), *available at* <http://www.oecd.org/daf/inv/FDI%20in%20figures.pdf>.

6. Elizabeth Whitsitt & Damon Vis-Dunbar, *Investment Arbitration in Brazil: Yes or No?*, INV. TREATY NEWS (Nov. 30, 2008), <http://www.iisd.org/itm/2008/11/30/investment-arbitration-in-brazil-yes-or-no/>; *ICSID Database of Bilateral Investment Treaties*, INT'L CTR. FOR THE SETTLEMENT INV. DISPS., <https://icsid.worldbank.org/ICSID/FrontServlet?RequestType=ICSIDPublicationsRH&actionVal=ViewBilateral&reqFrom=Main>.

7. For a discussion of the arguments for and against ratification of Brazilian BITs, see Whitsitt & Vis-Dunbar, *supra* note 6.

acknowledgement and even-handed, dignified treatment of the voice expressed by Brazilian legislators. Ultimately, such voice and acknowledgement led to executive and legislative collaboration in the creation of new, unbundled legislation that responded to state concerns while also providing sufficient protection to foreign investors. Such products include: constitutional equal protection for foreign investors, protections for the free flow of capital, double taxation treaties, investment opportunities through privatization and concessions, and arbitration law reforms.

For Brazil's domestic constituents and its foreign investors, these alternative approaches to investment protection actually represent superior products that were *more* responsive than BITs to the needs and interests of the state at that time. Far from representing failure, then, the development of these products represents a success for Brazil's domestic and foreign stakeholders. Perhaps as evidence of this, foreign investment in Brazil continues to be strong.⁸

Meanwhile, Brazil's role in foreign investment has evolved as its own multinational corporations increasingly engage in foreign investment. Inevitably, these corporations seek to reduce the risk of *their* foreign investments. As a result, they may encourage Brazil's executive and legislative branches to take a second look at BITs. As circumstances change, so may the definition of success.

This Article begins, in Part II, by describing the economic and political context within which Brazil began its consideration of BITs. Part III recounts Brazil's history with BITs in some detail. Part IV examines alternative investment protection legislation adopted in Brazil. Part V then turns to Hirschman's theory of exit, voice, and loyalty, as well as the theories and research of procedural justice, to

8. While the Brazilian economy has certainly taken a downturn since its historic rise after the global financial crisis, *see Has Brazil Blown It?*, ECONOMIST, Sept. 28, 2013, *available at* <http://www.economist.com/news/leaders/21586833-stagnant-economy-bloated-state-and-mass-protests-mean-dilma-rousseff-must-change-course-has>, the country accounted for "47 percent of South America's total [FDI] in 2013" and "remained significant at \$63 billion." *Global Foreign Direct Investment Rises to Pre-Crisis Levels*, U.N. NEWS CTR. (Jan. 28, 2014), <http://www.un.org/apps/news/story.asp/story.asp?NewsID=47029&Cr=trade&Cr1=#.U0HHPK1dXgI>; *see also* Gustavo Fernandes de Andrade & Gustavo Henrique Justino de Oliveira, *Investment Treaties, Foreign Investment and Brazilian Law: The Magic of Reality*, in INVESTMENT PROTECTION IN BRAZIL 88–89 (Daniel de Andrade Levy, Ana Gerda de Borja & Adriana Noemi Pucci eds.).

apply them to Brazil's history with BITs and to consider the particular relationship between procedural justice and loyalty. Ultimately, the Article urges that Hirschman's theory and the theories and research regarding procedural justice encourage a reconceptualization of Brazil's alleged "failure" in choosing not to ratify the BITs that had been negotiated by its diplomats.

II. BRAZIL'S EVOLVING ECONOMIC LIBERALIZATION AND INTEREST IN THE PROTECTION OF FOREIGN INVESTMENT

The Brazilian experience with BITs must be understood within the larger context of the country's evolution in terms of economics and politics. Brazil's approach to economic liberalization, meanwhile, fits within the even larger context of economic trends occurring worldwide and in the Latin American region.⁹ In particular, reaction to the Mexican debt crisis of 1982¹⁰ and Bolivian hyperinflation in 1985¹¹ led to a trend of economic liberalization in Latin America.¹² Often, with guidance from international organizations such as the World Bank, and with input from developed nations' experts,¹³ Latin American nations opened their economies to foreign competition. Their goals were to achieve growth in their gross domestic product and to gain the spillover effects of development.¹⁴ The countries in this region understood BITs would signal their interest in direct

9. See Leslie Bethell, *Brazil and 'Latin America,'* 42 J. LAT. AM. STUD. 457 (2010).

10. See Richard H.K. Vietor & Eilene Zimmerman, *Mexico in Debt, Case No. 9-797-110*, HARV. BUS. REV., Feb. 12, 2001, at 3.

11. See Rafael Di Tella & Huw Pill, *Bolivia: Globalization, Sovereignty, or Democracy?*, Case No. 9-702-086, HARV. BUS. REV., Mar. 12, 2003, at 5–7.

12. Daniel de Andrade Levy & Rodrigo Moreira, *ICSID in Latin America: Where Does Brazil Stand?*, in INVESTMENT PROTECTION IN BRAZIL 17, 20 (Daniel de Andrade Levy, Ana Gerdau de Borja & Adriana Noemi Pucci eds., 2013) ("In the process of liberalization of the Latin-American economies, known as the *Apertura*, where most public services were privatized and access to natural resources—especially oil and gas—was conceded to international companies, several BITs were signed in order to attract FDI [foreign direct investment], which consequently led to the fall of the Calvo Doctrine in the region.")

13. See, e.g., the work of Jeffrey Sachs in Bolivia during the country's 1985 efforts toward stabilizing hyperinflation. Jeffrey Sachs, *The Bolivian Hyperinflation and Stabilization*, 77 AM. ECON. REV. PAPERS & PROC. 279 (1987), available at http://www.earth.columbia.edu/sitefiles/file/about/director/documents/AER0587_000.pdf.

14. See ECONOMIC LIBERALIZATION, DISTRIBUTION, AND POVERTY: LATIN AMERICA IN THE 1990S (Rob Vos, Lance Taylor & Ricardo Paes de Barros eds., 2002).

foreign investment, and would promote such investment by providing certain substantive assurances to investors and a neutral method of resolving any dispute that might arise.¹⁵ Brazil's execution of a wave of BITs in the mid-1990s, therefore, was entirely consistent with a worldwide¹⁶ and Latin American phenomenon.¹⁷

During this period, Brazil transitioned from a military government with a largely closed economy, guided by import substitution industrialization principles,¹⁸ to a civilian-led, constitutional democracy.¹⁹ Fernando Collor de Mello, the first popularly elected Brazilian president after the conclusion of the military regime, established largely neoliberal economic policies during the early 1990s. His successor, Itamar Franco,²⁰ continued such policies. These policies were aimed at attracting and protecting investment,²¹ and

15. Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, 73 *FORDHAM L. REV.* 1521, 1523 (2005).

16. See Andrew T. Guzman, *Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 *VA. J. INT'L L.* 639 (1998) ("As of July 1996, there were 1010 BITs in existence around the globe, more than half of which have been signed or brought into force since the start of 1990.").

17. See Levy & Moreira, *supra* note 12, at 20.

18. PEDRO DA MOTTA VEIGA, *INTER-AMERICAN DIALOGUE, BRAZIL'S STRATEGY FOR TRADE LIBERALIZATION AND ECONOMIC INTEGRATION IN THE WESTERN HEMISPHERE 2* (June 1996), available at <http://www.thedialogue.org/PublicationFiles/Brazil's%20Strategy%20for%20Trade%20Liberalization%20and%20Economic%20Integration%20in%20the%20Western%20Hemisphere.pdf>. Import substitution industrialization is an economic policy adopted by many developing countries, especially in Latin America, with the aim of supplementing economies previously based solely on the export of agricultural products by substituting previously imported manufactured goods with locally produced goods, thus increasing domestic manufacturing opportunities and thus overall industrialization and development. The consequence of this policy, it is argued, is a generally closed economy that utilizes trade barriers to promote and protect local industry. See JEFFREY FRIEDEN, *GLOBAL CAPITALISM: ITS FALL AND RISE IN THE TWENTIETH CENTURY 220-29* (2006); see also Werner Baer & Isaac Kerstenetzky, *Import Substitution and Industrialization in Brazil*, 54 *AM. ECON. REV.* 411, 413-14 (1964).

19. See David V. Fleischer, *Government and Politics, in BRAZIL: A COUNTRY STUDY 256* (Rex A. Hudson ed., 5th ed. 1998), available at <http://lcweb2.loc.gov/frd/cs/brtoc.html>.

20. Franco became President after Collor de Mello resigned after being impeached by the Brazilian Congress. Jeb Blount & William R. Long, *Brazil President Resigns in Wake of Impeachment*, *L.A. TIMES*, Dec. 30, 1992, available at http://articles.latimes.com/1992-12-30/news/mn-2585_1_vice-president.

21. See Fleischer, *supra* note 19; Ross Schneider, *Brazil Under Collor: Anatomy of a Crisis*, 8 *WORLD POL'Y J.* 321, 326 (1991); Francisco Panizza, *Neopopulism and Its Limits in Collor's Brazil*, 19 *BULL. OF LATIN AM. RES.* 177, 184-86 (2000) (describing Collor's "high risk strategy" of combining an anti-inflationary package, exchange rate liberalization, opening

they included the country's accession to the Multilateral Investment Guarantee Agency Convention (MIGA),²² execution of double-taxation treaties,²³ trade and financial liberalization, and the privatization of state-owned entities.²⁴ BIT negotiations also began during this time.²⁵ Privatization was perhaps the most influential factor in prompting the government to encourage investment protection measures. The provision of risk reduction to foreign investors would result in direct benefits to the government, which

to external competition, decreased import tariffs, and the National Privatisation Programme. Panizza details the implementation of this strategy as one of "imposition rather than negotiation," noting that "the plan was drafted in secret by a closed group of economic advisers, mostly academics and businessmen, with no links to the techno-bureaucracy which had traditionally dominated economic policy making in Brazil.")

22. MIGA, a branch of the World Bank Group, provides political risk insurance guarantees to private sector investors, with the aim of promoting foreign direct investment. By joining MIGA as a member country, investments (as defined by the MIGA convention) in the country become eligible for a MIGA insurance guarantee, subject to approval by the host country. MIGA, as an organization, also conducts research and works with developing countries to improve the environment for FDI. *See generally* Convention Establishing the Multilateral Investment Guarantee Agency, Oct. 11, 1985, 1508 U.N.T.S. 99, available at http://www.miga.org/documents/miga_convention_november_2010.pdf. Brazil became a MIGA member on January 7, 1993. *Miga Members*, WORLD BANK, <http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,contentMDK:20122866~menuPK:329836~pagePK:34542~piPK:329829~theSitePK:29708,00.html> (last updated Nov. 11, 2013).

23. Double taxation treaties are bilateral agreements with the aim of preventing the taxation of the same taxpayer with regards to the same subject matter for identical periods. This occurs when countries adopt different theories of taxation that can overlap, e.g., one country imposing taxes based on residency and another based on the source of income. Fabian Barthel, Matthias Busse & Eric Neumayer, *The Impact of Double Taxation Treaties on Foreign Direct Investment: Evidence from Large Dyadic Panel Data*, 28 CONTEMP. ECON. POL'Y. 366, 367 (2010). Brazil has approximately twenty-eight DTTs in place, nine of which were negotiated and signed between 1988 and 2002 (India in 1988, Korea in 1989, Netherlands in 1990, China in 1991, Finland in 1996, Portugal in 2000, Chile in 2001, and Israel and Ukraine in 2002). Three have been signed since 2002, and it has been reported that Brazil is actively negotiating with other countries. *Double Taxation Conventions*, RECEITA FED., <http://www.receita.fazenda.gov.br/principal/ingles/Acordo/DuplaTributDefault.htm> (last visited Mar. 18, 2014); see also Juliana Mello, *Brazil and International Tax Treaties*, BRAZIL BUS., <http://thebrazilbusiness.com/article/brazil-and-international-tax-treaties> (May 4, 2012).

24. See Panizza, *supra* note 21; CELIO HIRATUKA, WORKING GRP. ON DEV. & ENV'T IN THE AMS., FOREIGN DIRECT INV. & TRANSNAT'L CORPS. IN BRAZIL: RECENT TRENDS & IMPACTS ON ECON. DEV. 1 (Apr. 2008), available at <http://ase.tufts.edu/gdae/Pubs/rp/DP10HiratukaApr08.pdf>.

25. Leany Lemos & Daniela Campello, *The Non-Ratification of Bilateral Investment Treaties in Brazil: A Story of Conflict in a Land of Cooperation* 7-8 (Princeton University Department of Politics, April 1, 2013), available at <http://ssrn.com/abstract=2243120>.

sought to profit generously from the sale of state-owned entities.²⁶ With these various policy initiatives, Brazil made a concerted effort to signal that the country was a safe and worthwhile investment.

Fernando Henrique Cardoso assumed the presidency in 1995 and expanded upon Collor de Mello's initial principles. The Cardoso administration's "Real Plan" included a series of monetary and financial reforms, which involved a new phase of privatizations and coincided with reductions in various trade barriers.²⁷ During this time, Brazil began negotiations of the Multilateral Agreement on Investments (MAI), and promulgated both concessions and arbitration laws. This trend in policy both maximized governmental interests and represented a reaction to a chorus of international corporate and organizational calls for liberalization of foreign direct investment.²⁸ At the time, Brazilian media encouraged policies to attract investors and often highlighted rival Argentina's strategies in privatization and market-based reforms.²⁹ Multinational corporations that had already initiated investments in Brazil also expressed interest in investment protection.³⁰ Importantly, however, the corporations focused on issues such as cross-border capital transfers and national treatment, rather than BITs in particular. This will be discussed in Part IV, *infra*.³¹

In the midst of these economic and political developments, Brazil continued to execute BITs. Further, as will be described in more detail *infra*, the Brazilian Congress began to consider them for ratification. The Brazilian executive branch also created an

26. *Id.* at 8. The Brazilian Congress also took steps in other areas of reform to increase the attractiveness of its privatization program. For example, the 1997 reform to the Corporations Law limited various minority shareholder rights, such as tag-along tender offers and reductions in withdrawal rights, with the goal of making state-owned entities with minority shareholders more attractive to large-scale buyers wishing to acquire controlling blocks. See Bruno M. Salama & Viviane Muller Prado, *Legal Protection of Minority Shareholders of Listed Corporations in Brazil: Brief History, Legal Structure and Empirical Evidence* 4–5 (Fundação Getúlio Vargas Law School at São Paulo, May 2011), available at <http://ssrn.com/abstract=1856634>.

27. VEIGA, *supra* note 18, at 3.

28. Lemos & Campello, *supra* note 25, at 7–8; Whitsitt & Vis-Dunbar, *supra* note 6.

29. *Id.* at 8.

30. *Id.*

31. *Id.* at 7–8. These concepts were included in BITs, but were also addressed through other legal forms, such as ordinary legislation, as will be discussed in Part IV, *infra*.

Interministerial Working Group to develop a model BIT. Brazil's negotiations over BITs, however, must be understood as largely reactive.³² In most cases, the home states of international investors initiated the negotiation process for Brazilian BITs as they sought to assist their corporations with managing costs and risk.³³ It has been reported, for example, that countries like Germany sought to execute BITs with Brazil based on the argument that without such agreements, credit would be expensive for their citizen-investors.³⁴ More systemically, Brazil's earlier accession to the MIGA pushed the state toward BITs.³⁵ If there is a BIT in place between an investor country and the host country, MIGA considers there to be an adequate level of legal protection.³⁶ Without a BIT, on the other hand, an applicant-foreign investor bears the burden of demonstrating the host country has sufficient alternate legal protections regarding fair and equitable treatment.³⁷

Many countries had formally proposed BITs to the Brazilian government as of 1990, and there were eleven negotiations under way in 1993.³⁸ This process produced fourteen signed BITs—with Portugal, Chile, the United Kingdom, Ireland, and Switzerland in 1994; Denmark, Finland, France, Germany, Italy, and Venezuela in 1995; Cuba in 1997; the Netherlands in 1998; and Belgium in 1999.³⁹ (Much earlier, in 1966, Brazil had executed—and ratified—a BIT with the United States. However, “it created an enormous controversy, and never came to be applied.”⁴⁰). The other fourteen

32. Lemos & Campello, *supra* note 25, at 9.

33. *Id.*; see also *ICSID Database of Bilateral Investment Treaties*, INT'L CTR. FOR THE SETTLEMENT INV. DISPS., <https://icsid.worldbank.org/ICSID/FrontServlet>.

34. Lemos & Campello, *supra* note 25, at 7.

35. *Id.*

36. KARL SAUVANT, YEARBOOK ON INTERNATIONAL INVESTMENT LAW & POLICY 559–60 (2009–2010).

37. *Id.*

38. Lemos & Campello, *supra* note 25, at 9.

39. Paulo Macedo Garcia Neto, *Investment Arbitration in Brazil: The Landscape of Investment Arbitration in Brazil and Why Brazil Should become a More Important Player in the Investment Arbitration Arena*, in INVESTMENT PROTECTION IN BRAZIL 3, 6 n.15 (Daniel de Andrade Levy, Ana Gerdau de Borja & Adriana Noemi Pucci eds.).

40. *Id.* at 7. It is useful to recall that the U.S.-Brazil BIT likely was ratified during the period when Brazil's military dictatorship was in power. TERESA A. MEADE, A BRIEF HISTORY OF BRAZIL 164 (2010).

signed BITs never even reached ratification, as described *infra*, and ultimately were removed from consideration at the end of 2002.⁴¹

Having consistently been rated as a “safe harbour for investments”⁴² and an “investment grade country”⁴³ that receives the fifth largest amount of foreign direct investment (FDI)⁴⁴ globally,⁴⁵ Brazil’s Foreign Affairs Ministry (“Itamaraty”) has recently re-initiated investment-related negotiations in certain strategic situations.⁴⁶ There are reports of both negotiations and attempted negotiations with Chile, Canada, India, and the European Union (EU), and Brazil has signed approximately eleven memorandums of understanding—mostly with fellow members of the Global South.⁴⁷

41. Lemos & Campello, *supra* note 25, at 7–8.

42. Neto, *supra* note 39, at 4.

43. *Credit Trends: Emerging Markets Credit Metrics: Brazil Shows Positive Rating Trends*, STANDARD & POOR’S (Aug. 24, 2012, 9:45 AM), <http://www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245339022519>.

44. The OECD provides the following definition of foreign direct investment: “FDI is defined as cross-border investment by a resident entity in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the enterprise. Ownership of at least 10% of the voting power, representing the influence by the investor, is the basic criterion used.” *OECD Factbook 2013: Economic, Environmental and Social Statistics*, OECD ILLIBRARY (Apr. 6, 2014), <http://www.oecd-ilibrary.org/sites/factbook-2013-en/04/02/01/index.html?itemId=/content/chapter/factbook-2013-34-en>. However, the definition of “investment” in general is subject to significant debate, especially in the context of investment treaty arbitration. See generally Tony Cole & Anuj Kumar Vaksha, *Power-Conferring Treaties: The Meaning of ‘Investment’ in the ICSID Convention*, 24 LEIDEN J. INT’L L. 305 (2011).

45. Daniel Tavela Luis & Luis Antonio Gonçalves de Andrade, *Expropriation in Brazilian Law: An International Standard?*, in INVESTMENT PROTECTION IN BRAZIL 107, 107 (Daniel de Andrade Levy, Ana Gerda de Borja & Adriana Noemi Pucci eds.).

46. Neto, *supra* note 39, at 7.

47. Lemos & Campello, *supra* note 25, at 8. The Global South is used here as the evolving synonym for the Third World. While the definitions of First and Second worlds have been subject to different perspectives, the term “Third World” or “Global South” has been used to refer to “Africans, Asians, and Latin Americans, that is the people of the countries located roughly in three southern continents and sharing a history of underdevelopment and colonialism.” JACQUILINE ANNE BRAVEBOY-WAGNER, INSTITUTIONS OF THE GLOBAL SOUTH 1–2 (2009).

III. THE NEGOTIATION, SIGNING, AND RATIFICATION PROCESS

The Brazilian executive branch, the central and most powerful source of international policy for the country, possesses the prerogative to enter into treaty negotiations.⁴⁸ Within the executive branch, the Foreign Affairs Ministry, known as the Itamaraty, leads the delegations for negotiating international treaties.⁴⁹ Any documents signed by the Itamaraty delegation are sent to the Casa Civil, or the ministerial equivalent of the presidential chief of staff.⁵⁰ The president is then required to send the treaty to the Brazilian Congress, along with an explanation, or *Exposição de Motivos*, to begin the ratification process.⁵¹

Brazil is recognized as having one of the most influential and powerful executives in terms of its procedural and persuasive influence over the legislature.⁵² Indeed, approximately 85 percent of the legislation adopted in Brazil originates in the executive branch and encounters little resistance from the legislature.⁵³ The Brazilian Congress is not without power, however. Treaties are not effective unless ratified by the Congress.⁵⁴ Increasingly, the Brazilian Congress has made such ratifications subject to conditions or reservations.⁵⁵ The ratification process for BITs, however, does not permit automatic legislative modification.⁵⁶ Rather, the legislature only has the power to ratify without reservations, ratify with reservations, or refuse to ratify a BIT.⁵⁷ While Congress may not amend the text of the treaty, it can make reservations indicating its disagreement with the text.⁵⁸ At the time of the BIT ratification debates, there was some uncertainty as to whether such reservations

48. *Id.* at 11.

49. *Id.*

50. *Id.*

51. *Id.*

52. See MATTHEW SOBERG SHUGART & JOHN M. CAREY, *PRESIDENTIAL ASSEMBLIES: CONSTITUTIONAL DESIGN AND ELECTORAL DYNAMICS* (1992).

53. Lemos & Campello, *supra* note 25, at 9.

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.* at 9–11.

58. *Id.* at 14.

would have the effect of amendments, and thus require renegotiation at the international level.⁵⁹ The consequences of such uncertainty are discussed in this part, *infra*. Importantly, the treaty ratification process does not incorporate a presidential veto, increasing the power of Congress in this particular area of international relations.⁶⁰

The Brazilian Congress has two chambers, both of which are involved in the treaty ratification process. The president first sends a treaty to the Chamber of Deputies (CD). This chamber then has a two-step committee approval system, beginning with the gatekeeping committee on Foreign Affairs and National Defense, which approves or disapproves the treaty and sends it to a floor vote. After this initial committee consideration and floor vote, the treaties are submitted as legislative decree bills to a set of two or three subject-specific committees. In this case, the treaties were submitted to the Finance and Taxes Committee; the Economic Development, Industry, and Commerce Committee; and the Constitution, Justice, and Citizenship Committee. If approved, the treaties are subject to another floor vote, where they must receive a simple majority. Throughout this process in the CD, debate and consideration is guided by a rapporteur chosen by the chairmen of the committees, usually on the basis of party position.⁶¹ If the CD rejects the treaty, the process concludes. If the CD votes in favor of the treaty, it sends it to the Senate, where it is considered by the Foreign Affairs and National Defense Committee and is then subject to a floor vote. During this entire process, individual delegates and senators can propose reservations (or amendments) to the bills, which also trigger reconsideration by the relevant committees.

The first four BITs signed by Brazil were introduced into this process together.⁶² Despite the governing coalition's control over the relevant committees, they took two years to be tabled and voted upon at the gatekeeping committee level.⁶³ Even with this delay, inevitable approval was considered likely, as many of the key rapporteurs

59. *Id.* at n.13.

60. *Id.* at 11.

61. *Id.* at 15.

62. *Id.* at 17–18.

63. *Id.* at 18.

championed the treaties as a way to increase the country's competitiveness and to signal Brazil's departure from typical third world practices.⁶⁴

However, after this point, the treaties received atypical and perplexing treatment, marking an unusual departure from traditional executive-legislative relations.⁶⁵ The ratification process was slowed significantly, based partially on shifting coalitions and control of power, and partially on competing legislation.⁶⁶ These two realities exposed decreased advocacy and determination by the very party that introduced the treaties—the executive.⁶⁷

On the floor and in subsequent committee considerations, the treaties faced opposition from members of the Worker's Party (PT)—a party which, at the time, had only 10 percent of Congressional seats—as well as some members of the governing coalition.⁶⁸ The treaties' scope of investment, provision of international arbitration, most-favored nation clauses, and constitutional conflicts served as the major sticking points.⁶⁹

With regard to the scope of investment, the opposition believed the original text allowed for speculative capital—the source of many emerging market economic crises⁷⁰—to fall within the definition of investment.⁷¹ This, along with developing doubts regarding the correlation between accession to BITs and increases in foreign investment,⁷² constituted the main economic concern raised by the opposition. Because the government could not (or would not) distinguish between the investments that could come within the scope of the BIT, Brazil could neither prompt productive growth nor protect

64. *Id.* (describing Third World nations as tending to institute closed economies and practice protectionism, often leading to dysfunctional economies when paired with political risk).

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.* at 18–19.

69. *Id.*

70. See generally Dilip K. Das, *Private Capital Flows and Speculative Runs in Emerging Market Economies*, 4 J. ASIA PAC. ECON. 413 (1999).

71. Lemos & Campello, *supra* note 25, at 18–19.

72. For a criticism of the correlation between bilateral investment treaties and foreign direct investment, see Jason Webb Yackee, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*, 51 VA. J. INT'L L. 397 (2011).

itself against the more dangerous forms of investment.⁷³ Thus, more liquid and short-term capital flows, such as portfolio investments, could be given the same protections from government restriction as more permanent (and thus desirable) forms, such as physical investments.⁷⁴

International investment arbitration, especially under the auspices of the World Bank's ICSID, concerned the opposition for a variety of reasons. First, it contradicted the Calvo Doctrine that guided Latin American policies toward foreign investment for over a hundred years.⁷⁵ Specifically, the creation of an international forum ran against the Doctrine's rejection of perceived imperial imposition of the preferences of more powerful states, as well as its advocacy for exclusive local jurisdiction for disputes between the state and foreign investors.⁷⁶ Nonetheless, Brazilian courts have held that commercial and investment arbitration is constitutional.⁷⁷ This concern about

73. Dan Wei, *Bilateral Investment Treaties: An Empirical Analysis of the Practices of Brazil and China*, EUR. J.L. & ECON. 663, 672 (2012).

74. *Id.*

75. Wenhua Shan, *From North-South Divide to Private-Public Debate: Revival of the Calvo Doctrine and the Changing Landscape in International Investment Law*, 27 NW. J. INT'L L. & BUS. 631, 632 (2007).

76. *Id.*; see also Lemos & Campello, *supra* note 25, at 19. Some states preferred that investors be subject to the laws and standards of the nation in which they invest, rather than being afforded the protection of an international standard of treatment that would come with a transnational tribunal—particularly in Latin American states that had adopted the Calvo Doctrine. See STEPHAN W. SCHILL, *THE MULTILATERALIZATION OF INTERNATIONAL INVESTMENT LAW* 25, 26–7 (2009); Bernardo M. Cremades, *Resurgence of the Calvo Doctrine in Latin America*, 7 BUS. L. INT'L 53, 55–56 (2006); James Thuo Gathii, *War's Legacy in International Investment Law*, 11 INT'L CMTY. L. REV. 353, 355, 362–63 (2009); Mary Helen Moura, *The Conflicts and Controversies in Latin American Treaty-Based Disputes*, in *LATIN AMERICAN INVESTMENT TREATY ARBITRATION: THE CONTROVERSIES AND CONFLICTS* 8 (Thomas E. Carbonneau ed., 2008); Alejandro A. Escobar, *Introductory Note on Bilateral Investment Treaties Recently Concluded by Latin American States*, 11 ICSID REV. 86–87 (1996) (“The conclusion of BITs by Latin American states is in itself noteworthy, due to the traditional position these states have had in regard to the international legal protection of foreign investment. . . . Their officials and scholars have advanced the exclusive jurisdiction of the host state's courts over investment disputes and the settlement of these disputes primarily on the basis of that state's domestic law.”).

77. Julio C. Barbosa, *Arbitration Law in Brazil: An Inevitable Reality*, 9 SW. J.L. & TRADE AM. 131, 131–32 (2002); Daniel M.C. Barbosa & Pedro Martini, *Two Sides of the Same Coin: To What Extent is Arbitration with the Brazilian Administration Similar to Investment-Treaty Arbitration?*, in *INVESTMENT PROTECTION IN BRAZIL* 37, 41 (Daniel de Andrade Levy et al. eds., 2013) (“The understanding that the Brazilian state may submit disputes to arbitration

arbitration was about much more than the mere procedural removal of investor-state disputes from national courts, however. International arbitration raised serious questions about imperialism, sovereignty, and international arbitrators' ability or willingness to respect Brazil's social and developmental concerns.⁷⁸ These substantive principles had been given a prominent place in the country's 1988 Constitution,⁷⁹ but it was unclear whether international arbitrators would perceive themselves as bound by Brazilian law or public policy.⁸⁰ The opposition's concerns were perhaps verified by Argentina's experience with ICSID in the wake of its financial crisis in the early 2000s.⁸¹

Second, and more generally, the relationships among the Organization for Economic Cooperation and Development (OECD),⁸² the World Bank, ICSID, and BITs raised fears of arbitral support for

has been confirmed by Brazilian courts"). *See also* discussion *infra*, pages 127–28 regarding the Brazilian Supreme Court's 2001 ruling on arbitration.

78. *See, e.g.*, Lemos & Campello, *supra* note 25, at 20 (detailing the rapporteur's concern that bilateral investment treaties would restrict the government from regulating certain economic matters, specifically capital).

79. Keith S. Roseann, *Conflict Resolution and Constitutionalism: The Making of the Brazilian Constitution of 1988*, in *FRAMING THE STATE IN TIMES OF TRANSITION: CASE STUDIES IN CONSTITUTION MAKING* 452 (Laurel E. Miller ed., 2010) (describing the Brazilian Constitution as "*dirigiste* and programmatic, setting out ambitious goals for reforming Brazilian society and attempting to determine the political course of action for future governments").

80. While the arbitral seat is able to impose its standards for vacatur under the New York Convention, it is important to recall that Brazil had not ratified the Convention until 2002. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 330 U.N.T.S. 3 (June 10, 1958).

81. *See* Eric David Kasenetz, Note, *Desperate Times Call for Desperate Measures: The Aftermath of Argentina's State of Necessity and the Current Fight in the ICSID*, 41 *Geo. Wash. Int'l L. Rev.* 709 (2010) (describing the negative legal treatment of the emergency measures put into place during the Argentinian financial crisis).

82. The OECD is an intergovernmental organization with thirty-four member states that share economic expertise with the aim of fostering economic development in emerging economies. The member states of the OECD are known to be the most economically advanced in the world, but membership is "limited only by a country's commitment to a market economy and a pluralistic democracy." JAMES K. JACKSON, CONG. RESEARCH SERV., RS21128: ORG. FOR ECON. COOP. & DEV. (2010), available at <http://www.fas.org/sgp/crs/misc/RS21128.pdf>. The thirty-four member states include Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, and the United States. *Members and Partners*, ORG. FOR ECON. COOP. & DEV., <http://www.oecd.org/about/membersandpartners/> (last visited Feb. 19, 2014).

remedies consistent with the sorts of painful neoliberal economic reforms and standards imposed by the World Bank in response to the series of economic crises in Latin America in the 1980s and 1990s.⁸³ Brazil had postured itself as an alternative source of development policy,⁸⁴ rather than adopting and embracing the economic suggestions put forth by the World Bank and other organizations like the OECD. This concern regarding the potential remedies imposed by arbitrators was particularly evident among the opposition parties standing to the left of the governing coalition.⁸⁵

Lastly, the BITs were seen as reciprocal only in the most formal sense, because they did not impose equal restrictions on the investor or capital-exporting states.⁸⁶ Rather, in practice, the risk and burdens were placed on the state hosting investment, while the investor's home state only served to benefit through expanded protections for its constituents.⁸⁷

Regarding the "most favored nation" clauses in many BITs, which often allow investors to adopt more favorable measures than the treaty under which they would have standing,⁸⁸ the opposition objected on the basis of sovereignty. Opponents urged that Brazil should be able to form specialized agreements with particular countries⁸⁹ and offer preferred terms to those foreign investors.

Finally, there were objections that the BIT provisions requiring "prompt, prior and effective" compensation in the case of expropriation were in conflict with the preexisting constitutional structure for such takings.⁹⁰ The Brazilian Constitution has provisions regulating expropriation for various reasons and for the intended use of the land, and sets forth different methods of calculating damages for each.⁹¹ This, along with a payment system of cash releases that

83. Neto, *supra* note 39, at 13.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.* As Brazilian companies have themselves become foreign investors, the risks and burdens of BITs will be more equally allocated between Brazil and other signatory states.

88. Stephen W. Schill, *Multilateralizing Investment Treaties through Most Favored Nation Clauses*, 27 BERKELEY J. INT'L L. 496, 502 (2009).

89. Lemos & Campello, *supra* note 25, at 19.

90. Tavela Luis & Gonçalves de Andrade, *supra* note 45, at 118–23.

91. *Id.*

requires including the payment in the following year's budget,⁹² is much more detailed than expropriation and compensation, as broadly defined and envisioned by the BITs, thus creating conflicting standards.⁹³ BIT protection of the free transfer of capital also faced constitutional opposition, as Article 172 provides for Brazilian regulation of foreign capital investments and the remittance of profits.⁹⁴ Law No. 4390 specifically grants the Superintendency Council of the Currency and Credit the authority to impose restrictions upon imports and remittance of foreign capital, in the case of serious instability in the balance of payments.⁹⁵

As noted *supra*, the first four treaties to be sent to Congress cleared the gatekeeper committee stage only after two years, far exceeding the amount of time generally required for the majority of international treaties and agreements.⁹⁶ Despite the substantive objections described *supra*, the delay was attributed to the procedural demands of competing bills.⁹⁷ The three subject-specific committees had generally favorable opinions of the treaties but required two more years, as some opposition arose regarding specific provisions.⁹⁸ Ultimately, competing versions of the bills reached the floor of the House—one with an interpretative clause on expropriations and the other eliminating the international arbitration provisions.⁹⁹

At this point, there were significant delays in voting, due to fears regarding the cost of doing so.¹⁰⁰ If the treaties had been approved with the proposed modifications (or reservations), Brazil may have

92. *Id.* at 123 (observing that this requirement is not always met, and federal, state, and municipal entities may take up to twenty years to deposit the funds in the investor's bank account); Barbosa & Martini, *supra* note 77, at 56 (observing that governmental debts resulting from arbitral awards are to be included in the next year's budget "which will be paid in the chronological order of their presentation," which means "private parties holding an arbitral award against a state entity in Brazil will literally have to get in line").

93. *Id.*

94. *Id.*

95. Wei, *supra* note 73, at 673. Balance of payments refers to the difference between income from exports and the cost of imports. PETER J. MONTEIL, *MACROECONOMICS IN EMERGING MARKETS* 29 (2d ed. 2011).

96. Lemos & Campello, *supra* note 25, at 18.

97. Voting on the BITs was rescheduled twelve or more times. *Id.* at 19.

98. *Id.*

99. *Id.*

100. *Id.*

been required to reinstate negotiations with Switzerland.¹⁰¹ As more of the fourteen treaties were introduced, the PT continued to introduce amendments (or reservations) regarding free transfers, government approval for international arbitration, and the ability of Congress to regulate investments.¹⁰² This sent bills back to committees, where the PT had gained control over key seats. In addition, coalition members were beginning to shift in their opinions regarding BITs.¹⁰³ As a result, by 2000, the various treaties were stuck in either the first or second steps of committee review, with varying levels of modification from the original text.¹⁰⁴ This, again, increased the cost of a final vote, as renegotiation was necessary with additional countries that had already ratified the BITs.¹⁰⁵ In December 2002, this reality led President Cardoso to withdraw all BITs from the Brazilian Congress, just two weeks before he was to hand over the presidency to Luis Inácio “Lula” da Silva of the PT.¹⁰⁶

Despite acknowledging Congressional obstacles to ratification, Brazilian scholars Lemos and Campello also report, based on a series of interviews, that the executive showed a striking lack of willingness to exercise its significant persuasive powers to guarantee ratification of the BITs.¹⁰⁷ As mentioned *supra*, executive-legislative relations in Brazil are characterized by an assertive and central presidency.¹⁰⁸ Due to the fractured coalition system within Congress, deal making and negotiation often are organized by the executive, which has the resources and power to distribute, share, threaten to withdraw, or actually withdraw both the perks of cabinet-level and party appointments and “pork” for individual legislators and their constituencies.¹⁰⁹ This sort of leverage makes it entirely understandable why the executive is the source of approximately 85

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.* at 22.

106. *Id.*

107. *Id.* at 24.

108. *Id.* at 9.

109. *Id.* at 10. See generally Lee J. Alston & Bernardo Mueller, *Pork for Policy: Executive and Legislative Exchange in Brazil*, 22 J.L. ECON. & ORG. 87 (2005).

percent of the legislation adopted by Congress,¹¹⁰ and the creator of urgency in the legislative process.¹¹¹ The executive has utilized these tools of persuasion in a very effective manner, as provisional measures or decrees issued from this branch have rejection rates as low as 8 percent.¹¹² Thus, the resistance faced by the BITs, and the overwhelming failure in their ratification process, was highly unusual. However, Lemos and Campello point out that the BIT ratification process is not an instance of failed executive persuasion.¹¹³ Instead, it is more accurate to say that the executive tools of persuasion were never truly utilized to force ratification of the BITs, and the executive and legislative branches collaborated in the development of other investment protections and reforms over the same period of time.¹¹⁴ This has been attributed to disparate levels of commitment on behalf of the various elements within the executive, with the Finance Ministry, Central Bank, and Casa Civil considering the treaties to be much less of a priority than the diplomats in the Itamaraty, who themselves negotiated the treaties.¹¹⁵

Within the executive, the Itamaraty supported ratification of the BITs.¹¹⁶ But the other important departments within the executive—e.g., the Finance Ministry, Casa Civil, and the Central Bank—did not demonstrate commitment to or support for these treaties.¹¹⁷ Presumably, there was no assertive domestic constituency encouraging ratification, and this is significant. If the failed ratification process is attributed to the objections and procedural wrangling of the PT, this is a story typical of the workings of the Calvo Doctrine, and fits with the conduct of other Latin American countries that have broken ties with ICSID. However, this perspective fails to account for the many economic and legal policies put into place during the same time period that do not coincide with

110. Lemos & Campello, *supra* note 25, at 9.

111. Simone Diniz & Claudio Oliveira Ribeiro, *The Role of the Brazilian Congress in Foreign Policy: An Empirical Contribution to the Debate*, 2 BRAZILIAN POL. SCI. REV. 10, 23 (2008).

112. Lemos & Campello, *supra* note 25, at 9.

113. *Id.* at 24.

114. *Id.*

115. *Id.* at 24–25.

116. *Id.* at 28.

117. *Id.*

and, in fact, contradict the Calvo Doctrine and the socialist political leanings of the main opponents of international investment arbitration.¹¹⁸

Thus, although the Calvo Doctrine principles evoked to challenge the BITs during the ratification process may certainly have been main points of debate for the objecting parties, the real reason Brazil chose not to ratify the BITs may be because the key stakeholders' most important interests were satisfied better by the other investment protections developed during this period. The following part assesses with more depth the various other reforms promulgated in Brazil at the time BITs were under consideration, and evaluates the extent to which these alternative forms of protection responded to investor and business concerns that have traditionally been addressed through BITs.

IV. INVESTOR PRIORITIES AND ALTERNATIVE SOURCES OF INVESTMENT PROTECTION

During the same eight-year period in which the Brazilian Congress considered and eventually failed to ratify the BITs, it collaborated with the executive to make great strides in several other areas of investment reform and protection.¹¹⁹ Through this combination of legal structures, the executive and legislative branches met the most important needs of foreign investors while protecting the most important interests of the state, thus substantially eroding the perceived need for a BIT. Indeed, patterns of foreign investment in Brazil, as compared to BIT-adopting countries, contradict the common assumption of a necessary correlation between BITs and FDI.¹²⁰ Major elements of investment protection identified as international standards—e.g., equal treatment for foreign businesses, free flow of capital, access to neutral dispute resolution mechanisms, and investment incentives—were addressed by the

118. Fernandes de Andrade & Justino de Oliveira, *supra* note 8, at 91.

119. Lemos & Campello, *supra* note 25, at 28.

120. Fernandes de Andrade & Justino de Oliveira, *supra* note 118, at 87 (providing an empirical comparison of FDI between Brazil, Mexico, and Argentina from 1993 to 2012, as against the number of BITs in force).

Brazilian government during the 1990s and early 2000s.¹²¹ To a much more limited degree, the government also addressed the desire for arbitration.¹²²

A. *The Brazilian Constitution: Equal Treatment
and Capital Flow Restrictions*

As referenced *supra*, the nature of the Brazilian Constitution has elevated certain rights and issues to a constitutional, rather than legislative, level.¹²³ Many of the investment protections set forth by the Brazilian government were implanted directly into the Constitution, or had constitutional roots, elevating their protection within the legal system.¹²⁴ One such protection is found in Article 5 of the Constitution, which provides:

All persons are equal before the law, without any distinction whatsoever, Brazilians and foreigners residing in the country being ensured of inviolability of the right to life, to liberty, to equality, to security and to property, on the following terms:
.....¹²⁵

With this provision, foreign investors are assured both equal treatment and property rights within Brazil.¹²⁶ This is further elaborated on in Brazil's extensive provisions on expropriation, which, although different from the international standard in form, have been acknowledged as largely similar in substance.¹²⁷

With regard to free capital flows and remittance of profits, Article 192 of the Brazilian Constitution grants Congress the power to regulate the national financial system, as well as to establish conditions for foreign investments in domestic financial

121. *Id.*

122. *Id.*

123. Tavela Luis & Gonçalves de Andrade, *supra* note 45, at 118.

124. *Id.*

125. CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] art. 5 (Braz.).

126. Tavela Luis & Gonçalves de Andrade, *supra* note 45, at 108.

127. *Id.* at 125.

institutions.¹²⁸ Article 172 of the Constitution also provides for the regulation of foreign capital investments and remittance of profits.¹²⁹ Under the power granted in these provisions, Congress passed the Foreign Capital Law¹³⁰ and other pieces of legislation, which have been described as being “nationality blind” with regard to foreign investment.¹³¹ However, there still remains a regulatory exception in the case of balance of payment crises.¹³²

Foreign capital entering the country is subject to electronic registration for monitoring purposes yet does not need to meet any set of approvals or minimum investment authorizations.¹³³ Additionally, foreign capital investments are not subject to a minimum time period within the country or any substantive approvals or authorizations upon remittance of profits out of the country.¹³⁴ Under these conditions, Brazil is thought to provide a generally free flow of capital in and out of the country.

B. Investment Incentives: The Privatization Program and Double Taxation Treaties

The Privatization Program began in Brazil in 1990, and focused on the sale of productive state-owned companies in the fields of steel manufacturing, petrochemicals, and fertilizers.¹³⁵ In the first four years of the program, the country sold its controlling or minority shareholdings in thirty-three companies, earning the government \$8.6 billion and transferring \$3.3 billion in debt to the private sector.¹³⁶ Foreign buyers dominated the second phase of privatizations, from

128. Bruno Balduccini & Amina Akram, *Investment Protection in the Brazilian Banking Sector*, in INVESTMENT PROTECTION IN BRAZIL 193, 200 (Daniel de Andrade Levy, Ana Gerdau de Borja & Adriana Noemi Pucci eds., 2013).

129. Wei, *supra* note 73, at 673.

130. Lei No. 4.131 de 3 de Setembro de 1962 (“Lei de capitais Estrangeiros”).

131. Balduccini & Akram, *supra* note 128, at 205.

132. *Id.* at 209.

133. *Id.*

134. *Id.*

135. PowerPoint Presentation, Ministry of Dev., Indus. & Foreign Trade, Privatization in Brazil 6, 15, 29, 31 (Sept. 2002), available at http://www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_en/Galerias/Download/studies/priv_brazil.pdf.

136. *Id.*

1995 to 2002.¹³⁷ This was also the time period when public services were transferred to the private sector in the hopes of improving the quality of services provided to the Brazilian society.¹³⁸ The Brazilian government also initiated public offerings for Petrobras in the petroleum industry and Companhia Vale do Rio Doce in the mining industry.¹³⁹

The Brazilian government supplemented the Privatization Program with a policy of public service concessions and public private partnerships (PPPs), which are regulated by the Concessions Act and the Brazilian Public Private Partnerships Act, described *infra*.¹⁴⁰ These projects transfer the responsibility for development, financing, construction, and operation of public services to the private sector, while allowing the private actor to collect fees from users upon completion.¹⁴¹ Due to the dire need for infrastructure within the country and the various guarantees provided by the government in these PPP and concession contracts, these development structures have become very attractive for foreign investors.¹⁴²

Another form of investment incentive came in the form of double taxation treaties¹⁴³ (DTTs), which were ratified over the same period in which BITs were being considered by Congress.¹⁴⁴ In fact, twenty-four DTTs were approved without conditions.¹⁴⁵ Lemos & Campello report that industry representatives and multinational corporations

137. *Id.*

138. *Id.*

139. *Id.*

140. Eliana Baraldi & Jorge Vargas Neto, *Investment Arbitration and Public-Private Partnership Agreements in Brazil*, in *INVESTMENT PROTECTION IN BRAZIL* 159, 164 (Daniel de Andrade Levy, Ana Gerdau de Borja & Adriana Noemi Pucci, eds. 2013).

141. *Id.*

142. *Id.* at 163, 166–67.

143. Tax treaties are usually bilateral agreements that “play a key role in the context of international cooperation in tax matters. On the one hand, they encourage international investment and, consequently, global economic growth, by reducing or eliminating international double taxation over cross-border income. On the other hand, they enhance cooperation among tax administrations, especially in tackling international tax evasion.” U.N., *HANDBOOK ON SELECTED ISSUES IN ADMIN. OF DOUBLE TAX TREATIES FOR DEV. COUNTRIES* (Alexander Trepelkov, Harry Tonino & Dominika Halka eds.), available at http://www.un.org/esa/ffd/documents/UN_Handbook_DTT_Admin.pdf.

144. Lemos & Campello, *supra* note 25, at 29.

145. *Id.* at 25.

saw DTTs as their real priority, as compared to BITs, giving those treaties a distinct constituency that could motivate ratification.¹⁴⁶ This can perhaps be attributed to the immediate financial impact DTTs have on investors, as opposed to BITs, which serve mainly as a platform for dispute resolution and substantive standards in the event that a promised investment protection is breached.

C. Commercial and Investor-State Arbitration in Brazil

In its infancy, the very institution of arbitration itself faced challenges in Brazil. Though Congress ratified the Panama Convention in 1995,¹⁴⁷ passed its Arbitration Law in 1996,¹⁴⁸ and ratified the Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards (“Montevideo Convention”) in 1997,¹⁴⁹ arbitration was not fully accepted until the Brazilian Supreme Court upheld its constitutionality on December 12, 2001.¹⁵⁰ Prior to this ruling, the *Cláusula Compromissória* did not allow for the enforcement of agreements to arbitrate future disputes, whereas the new Arbitration Law more closely tracked UNCITRAL guidelines for deference to arbitration clauses that anticipate future disputes, as well as pending submissions to arbitration.¹⁵¹ After the constitutionality of this legislation was settled, Brazil quickly became a signatory to the New York Convention in 2002.¹⁵² Actions for recognition and enforcement of arbitral awards were first heard by the *Supremo Tribunal Federal* and were then dedicated to the *Superior Tribunal de Justiça*. These cases have received generally

146. *Id.*

147. Jonathan C. Hamilton, *Three Decades of Latin American Commercial Arbitration*, 30 U. PA. J. INT’L L. 1099, 1114 (2009).

148. Lei No. 9.307, de 23 Setembro de 1996, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 24.9.1996 (Braz.).

149. Lemos & Campello, *supra* note 25, at 13.

150. Julio C. Barbosa, *Arbitration Law in Brazil: An Inevitable Reality*, 9 SW. J.L. & TRADE AM. 131, 131–32 (2002).

151. *Id.*

152. *Id.* at 138; *see also* JAN PAULSSON, NIGEL RAWDING & LUCY REED, *THE FRESHFIELDS GUIDE TO ARBITRATION CLAUSES IN INTERNATIONAL CONTRACTS* 42 (3d ed. 2011).

positive treatment; the rare refusals to enforce were on procedural grounds.¹⁵³

In the wake of this turning of the tides in the area of commercial arbitration, the Brazilian Congress has managed to authorize state participation in two forms of dispute resolution. First, in 2004, Congress approved arbitration of PPP contracts, in accordance with the Brazilian Arbitration Act.¹⁵⁴ In the following year, Congress amended the Brazilian Concessions Law¹⁵⁵ to allow for the arbitration of disputes arising out of concessions contracts.¹⁵⁶ However, both of these laws are subject to two restrictions: (1) the language of the arbitration must be Portuguese, and (2) the arbitration must be seated in Brazil.¹⁵⁷

Along with these procedural conditions, there are other requirements for arbitration against Brazil or state entities—subjective arbitrability, objective arbitrability, and consent.¹⁵⁸ Subjective arbitrability refers to the capacity of a party to submit its dispute to arbitration.¹⁵⁹ In this case, the question would be whether municipal law grants the Brazilian Public Administration capacity to participate in arbitration.¹⁶⁰ Even though state entities are not granted legal personhood under Brazilian law, they do have contractual capacity.¹⁶¹ Thus, provisions in the Concessions Law and the Public-Private Partnerships Law are not specific authorizations but instead reinforcements of the Brazilian Arbitration Act, which allows the state to submit to arbitration—and to comply with an arbitral award.¹⁶²

153. Hamilton, *supra* note 147, at 1115 (detailing the cases where the Brazilian courts denied recognition or enforcement. Two cases were denied because the Brazilian party was improperly summoned, three cases where there was no valid written arbitration agreement, and one case where the arbitral award had been assigned to a third party that lacked standing to seek recognition and enforcement.)

154. PAULSSON ET AL., *supra* note 152, at 42.

155. Lei No. 8.987, de 13 de Fevereiro de 1995, DIÁRIO OFICIAL DA UNIÃO, [D.O.U.] de 14.02.1995 (Braz.).

156. PAULSSON ET AL., *supra* note 152, at 42.

157. *Id.*

158. Barbosa & Martini, *supra* note 77, at 39.

159. *Id.*

160. *Id.*

161. *Id.* at 41.

162. *Id.*

Objective arbitrability concerns whether the dispute is capable of being decided by arbitration.¹⁶³ Under the Brazilian Arbitration Act, this means “disputes related to freely transferrable patrimonial rights,” or rights exercised by their holder “that are not contrary to mandatory rules of the Brazilian legal system.”¹⁶⁴ In practice, this refers to disputes that could be solved by the parties themselves, without a mandatory intervention by the Brazilian courts—e.g., preservation of the economic-financial balance of the contract. The parties themselves may not resolve clauses imposed by the state to protect the public interest; these are considered inalienable.¹⁶⁵

Regarding consent, the absence of BITs significantly narrows the situations in which Brazil concedes to the jurisdiction of an arbitral tribunal. While BITs establish general consent upon which the investor may rely, or “arbitration without privity,” the Concessions Law and the Public Private Partnerships Law merely allow the state to be a party to arbitration.¹⁶⁶ Actual consent requires an individual contract in order to be upheld as valid under the Brazilian Arbitration Act.¹⁶⁷ Thus, there can be no “arbitration without privity.”¹⁶⁸

With these restrictions, Brazil has created a largely local or national-level system of investment arbitration that differs from the ICSID model in terms of language, location, the requirements for consent, and subject matter jurisdiction. These variances are likely to increase the need to interact with the national court system. Although the highest Brazilian court clarified the position of arbitration in Brazil in 2001, Brazil’s civil law judiciary and the absence of binding precedent can lead to extensive litigation in the Brazilian court system before or concurrent with arbitral proceedings.¹⁶⁹ However, it has also been urged that even without BITs and a system of ICSID-style quasi-precedential arbitral decisions, Brazil provides the same level of investment protection.¹⁷⁰ PPP agreements and concessions

163. *Id.* at 42.

164. *Id.*

165. *Id.* at 43.

166. PAULSSON ET AL., *supra* note 152, at 42.

167. Barbosa & Martini, *supra* note 77, at 57.

168. *Id.*

169. PAULSSON ET AL., *supra* note 152, at 42.

170. Whitsitt & Vis-Dunbar, *supra* note 6.

contracts are negotiable with regards to arbitration clauses, and the Brazilian Constitution—along with individual pieces of legislation—restricts expropriation without compensation, provides fair and equitable treatment, establishes strict liability by the state for its acts, and ensures free entry and exit of investments.¹⁷¹ In addition, it has been reported the Brazilian judiciary has consistently upheld arbitral clauses that designate the Brazilian government and its state-owned entities as parties.¹⁷²

V. USING THEORY AND RESEARCH TO REFRAME BRAZIL'S “FAILURE” TO RATIFY ITS BITS

A. Hirschman's Theory of Exit, Voice, and Loyalty

Albert Hirschman first wrote about the theory of exit, voice, and loyalty in 1970.¹⁷³ He focused primarily on markets and consumer goods, but the theory so succinctly and elegantly outlined the balancing factors for any organization that others soon applied it to states and international organizations.¹⁷⁴ Recognizing, as Hirschman does, that all organizations are inherently unstable, the theory of exit, voice, and loyalty serves as a method for understanding the pulls and pushes in and out of organizations. First, we explain the theory in more detail and then, we apply it to Brazil's refusal to ratify BITS.

Exit, which comes from the world of economics to analyze market factors, is generally defined as the ability of one party to leave or sever the relationship with the other party.¹⁷⁵ Under perfect market conditions—i.e., when there are multiple vendors offering a particular product—consumers can easily exit. Such exit will then communicate to a company it is not doing something right and must

171. Pedro Henrique Jardim, Note, *Are Investment Protection Mechanisms Provided by Brazilian Law as Effective as Stabilisation Clauses for Petroleum Investments?*, 15 *CTR. ENERGY, PETROLEUM & MIN. L. & POL'Y ANN. REV.* 9 (2013).

172. PAULSSON ET AL., *supra* note 152, at 42.

173. ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY* (1970).

174. For example, Joseph Weiler used exit, voice, and loyalty to analyze the historic development of the EU up to the early 1990's. Joseph H. H. Weiler, *The Transformation of Europe*, 100 *YALE L.J.* 2403, 2411 (1991). For another use of this rubric in domestic politics, see Heather Gerken, *Exit, Voice, and Disloyalty*, 62 *DUKE L.J.* 1349 (2013).

175. HIRSCHMAN, *supra* note 173, at 21.

change in order to stay competitive. As Hirschman notes, however, such choice of exit is not always feasible.¹⁷⁶ Consumers cannot exit from a monopoly; workers may not exit easily from a workplace; similarly, citizens may not exit easily from a country.

Voice comes from the world of politics and is a concept used in political science to assess participation.¹⁷⁷ It is “messy” compared to exit. Voice is the concept that one party will make an attempt to change the practices with which it is unhappy, rather than leave the relationship.¹⁷⁸ As Hirschman puts it, “[V]oice is here defined as any attempt at all to change, rather than to escape from, an objectionable state of affairs, whether through individual or collective petition to the management directly in charge, through appeal to a higher authority with the intention of forcing a change in management, or through various types of actions and protests, including those that are meant to mobilize public opinion.”¹⁷⁹

In business relations, voice occurs when consumers directly complain to management about a product, rather than choose to go elsewhere (i.e., complaining to Coca Cola about New Coke, rather than buying Pepsi, or complaining to Dell about its computers, rather than switching to Apple). In a democracy, citizens use voice frequently. Citizens are much less likely to consider exit (moving from the country) an option (although the continued occurrence and controversy associated with immigration indicates that a substantial minority of people are willing to exit their countries, depending on their living circumstances). In a democracy, citizens voice their disapproval through voting, protesting, expressing public opinions, mobilizing to offer or support candidates for office, and bringing lawsuits.¹⁸⁰

176. *Id.* at 56. As the EU evolved, Weiler notes that one of the key developments was closing off exit and requiring countries to follow the EU laws more closely. Weiler, *supra* note 174, at 2412–23. Weiler wrote his article in 1991, however, and one could argue that certain countries have since used selective exit with the EU.

177. HIRSCHMAN, *supra* note 173, at 30.

178. *Id.*

179. *Id.*

180. *Id.* at 32. As applied to the EU, voice is shown during the early years of the EU, when member states took control over the EU Commission in order to enact the policies that the member states desired.

So how do the concepts of voice and exit relate to each other? Hirschman argues most organizations are dominated by one or the other mechanism.¹⁸¹ If someone tries to exit when exit is essentially closed, as in families, clans, and some religious communities, there will be significant penalties.¹⁸² Voice then becomes the only option. We might analogize certain international structures (e.g., the UN or NATO) to a no-exit or monopoly situation, in which exiting is very difficult, costly, and thus rarely used.

Meanwhile, Hirschman argues that “[t]he presence of the exit option can sharply reduce the probability that the voice option will be taken up widely and effectively.”¹⁸³ Yet, “the decision to exit will often be taken in light of the prospects for effective use of voice.”¹⁸⁴ According to Hirschman, since voice takes effort, it will only be used in situations where influence is likely to work.¹⁸⁵ Voice is more likely to work for someone who is a member of an organization (e.g., serves on the board of a company that produces consumer products) than for an individual consumer who buys the company’s products. Ironically—and here is the problem with the interplay of voice and exit—those members who care most about the quality of a product are also the first ones to exit, even though their voice might be the most persuasive.¹⁸⁶ In these cases, when exit is used by the most influential and persuasive members, the organization itself faces decline. Hirschman uses public schools as an example, and it is useful to consider what happens when the most motivated and educated parents pull their children from public school, rather than try to improve the school.¹⁸⁷

Therefore, Hirschman argues, we can benefit from a monopoly in which parties cannot exit.¹⁸⁸ A monopoly is best utilized when exit would drain the best and brightest—the most “quality-conscious,

181. *Id.* at 120.

182. *Id.* at 96.

183. *Id.* at 76.

184. *Id.* at 37.

185. *Id.* at 39.

186. *Id.* at 47.

187. *Id.* at 51–54.

188. *Id.* at 55.

alert, and potentially activist”¹⁸⁹—and voice has the potential to be effective once the members are locked in. This assertion by Hirschman assumes, of course, that even locked-in members still have the capacity to use voice, and such voice has the potential to produce change.

According to Hirschman, loyalty moderates between the voice and exit options.¹⁹⁰ Loyalty makes exit less likely and voice more effective.¹⁹¹ When an individual is loyal to an organization, he or she is more likely to search for ways to be heard, or to gain influence or power in the organization to which he or she is loyal.¹⁹² For example, parents attend school board meetings, help in the classroom, or join the PTA. Such loyalty makes it more likely their voices will be heard—i.e., that the improvements they suggest will happen. As for exit, loyalty may postpone exit, but loyalty’s “very existence is predicated on the possibility of exit.”¹⁹³ Hirschman observes: “That even the most loyal member can exit is often an important part of his bargaining power vis-à-vis the organization.”¹⁹⁴ Indeed, the threat of exit can actually make the person’s voice more effective.¹⁹⁵ This assumes, however, that the threat is implicit rather than explicit. Explicit threats to leave, in fact, can communicate disloyalty.¹⁹⁶

In order to optimize organizations, a mix of both voice and exit is necessary. Even when organizations primarily rely on one mechanism, a jolt of the other is often necessary to improve the organization. Of course, as Hirschman notes, this requirement of both is inherently unstable.¹⁹⁷

This pull and push, the balancing of goals, and the concerns raised in the theory of exit, voice, and loyalty are all present in the context of international investment. If a foreign company is unhappy with the way its investment-related dispute is being treated in the host state’s

189. *Id.*

190. *Id.* at 76.

191. *Id.* at 77.

192. *Id.*

193. *Id.* at 82.

194. *Id.*

195. *Id.*

196. *Id.*

197. *Id.* at 120.

courts, and the state refuses to change its procedures or permit exit to private arbitration, the company may choose to withdraw its investment and thus exit entirely from the state. Alternatively, if a foreign company is contemplating an investment but fears how it will be treated in the host state's courts, the company may choose to forego investment. This logic appears to underlie arguments regarding the need for BITs. In other words, investment arbitration proponents argued throughout the 1990s that companies would refuse to invest in Brazil unless the state signed and ratified BITs.¹⁹⁸

The example of exit in Brazil, however, presents a mirror image. Brazil chose to exit from the BITs it had negotiated, rather than investors choosing to exit the Brazilian market. Brazil, as described *supra*, is one of the largest markets to choose to exit the international investment arbitration system. Was this, as Hirschman might hypothesize, because of unhappiness with the product? Was this because changing the product was more difficult than exiting? Or was this because voice could be acknowledged and met through the creation of different and more mutually-acceptable products?

All three of these factors explain why Brazil did not ratify the treaties. First, as outlined *supra*, different elements of Brazil's legislature were unhappy with the BITs and unpersuaded that these treaties provided significant advantages. In the early 2000s, Argentina offered a vivid demonstration of the troubles that could result from arbitration pursuant to BITs. Second, the negotiation structure itself made "voice" very difficult to exercise vis-à-vis each treaty. Any amendment potentially meant reopening negotiations with a foreign government and starting over. Most significantly, legislators used their opportunities for voice as various committees considered the treaties—and the legislators used voice again in the creation and ratification of other treaties and legislation that protected investors' most salient and immediate interests, while also

198. See U.N. CONFERENCE ON TRADE AND DEVELOPMENT, INVESTOR-STATE DISPUTES: PREVENTION AND ALTERNATIVES TO ARBITRATION, at 3, U.N. Doc. UNCTAD/DIAE/IA/2009/11, U.N. Sales No. E.10.ILD.11 (2010), available at http://www.unctad.org/en/docs/diaeia200911_en.pdf ("Host states wishing to attract and promote foreign investment often seek to offer predictability to foreign investors by favouring international arbitration as the means for investors to deal with a dispute.").

responding to Brazil's social, economic, and political concerns. Investors received what mattered most to them: free movement of capital and the elimination of double taxation (also acknowledged as primary considerations by MIGA).¹⁹⁹

The story of Brazil's refusal to ratify its BITs also may reveal some voices—i.e., the voices of the negotiating agents—as less important than those voices of the key players. The diplomats who negotiated the BITs certainly favored ratification of the product they presented to the Brazilian executive and Congress. But the BITs were simply means to accomplish the objectives of the executive and its core departments—i.e., the Finance Ministry, Central Bank, and Casa Civil. The voices of these departments were more important than those of the Itamaraty, and they were willing to accept alternative means to achieve their primary objectives.

Finally, the concept of loyalty might help to explain why the Congress was willing to ratify or pass other legislation and might be willing to consider further legislation or treaties. Brazilian multinationals may well advocate for BITs in the future to protect their own foreign investments. The Brazilian government might be willing to listen to the voices of these loyal companies as they explain the advantages of BITs and the investment arbitration system.

B. Brief Consideration of Procedural Justice Research and Theories

As with Hirschman's theory, procedural justice theory and empirical research in this area affirm the importance of voice. Indeed, the opportunity for voice is an extremely important element that persuades people that a decision-making or dispute resolution process is procedurally fair.²⁰⁰ This perception is important, because if people perceive a decision-making or dispute resolution procedure as fair,

199. See *supra* notes 20–24 and accompanying text.

200. See E. ALLEN LIND & TOM R. TYLER, *THE SOCIAL PSYCHOLOGY OF PROCEDURAL JUSTICE* 218 (Melvin J. Lerner ed., 1988); E. Allan Lind, *Procedural Justice, Disputing, and Reactions to Legal Authorities*, in *EVERYDAY PRACTICES AND TROUBLE CASES* 180 (Austin Sarat et al. eds., 1998); see also Nancy A. Welsh, Donna Stienstra & Bobbi McAdoo, *The Application of Procedural Justice Research to Judicial Actions and Techniques in Settlement Sessions*, in *THE MULTI-TASKING JUDGE: COMPARATIVE JUDICIAL DISPUTE RESOLUTION* 65–69 (Tania Sourdin & Archie Zariski eds., 2013).

they are more likely to perceive the resulting outcome of that procedure as fair, even if the outcome is not what they preferred.²⁰¹ People also are more likely to comply with the outcome²⁰² and perceive the institution providing the procedure as legitimate.²⁰³ As discussed briefly, *infra*, the willingness to judge a disadvantageous outcome as fair and the institution as legitimate suggests the potential for a relationship between perceptions of procedural justice and the emergence of loyalty as described by Hirschman.²⁰⁴

There is a vast socio-psychological literature revealing more about voice and the other procedural elements most likely to lead people to

201. See LIND & TYLER, *supra* note 200, at 66–70, 205; Tom R. Tyler, *Social Justice: Outcome and Procedure*, 35 INT'L J. PSYCHOL. 117, 119 (2000).

202. See Tyler, *Social Justice: Outcome and Procedure*, *supra* note 201, at 119; Lind, *supra* note 200, at 177, 192; Tom R. Tyler, *Psychological Models of the Justice Motive: Antecedents of Distributive and Procedural Justice*, 67 J. PERSONALITY & SOC. PSYCHOL. 850, 857 (1994); Tom R. Tyler, *Does the American Public Accept the Rule of Law? The Findings of Psychological Research on Deference to Authority*, 56 DEPAUL L. REV. 661, 664, 660–70, 673–74 (2006–2007) (describing procedural justice findings generally and research that has identified “procedural justice and trust as the key antecedents of the willingness to defer to legal authorities”).

203. See LIND & TYLER, *supra* note 200, at 209; TOM R. TYLER, WHY PEOPLE OBEY THE LAW 94–108 (1990); Lind, *supra* note 200, at 188; Tom R. Tyler, *Citizen Discontent with Legal Procedures: A Social Science Perspective on Civil Procedure Reform*, 45 AM. J. COMP. L. 871, 885–86 (1997) (suggesting that the influence of procedural justice judgments supports the idea that “the public has a very moral orientation toward the courts” and “[t]hey expect the courts to conform to their moral standards,” especially regarding “the fairness of the procedures by which the courts make decisions”); David B. Rottman, NAT'L CTR. FOR STATE COURTS, TRUST & CONFIDENCE IN THE CAL. COURTS 24 (2005), available at http://www.courts.ca.gov/documents/4_37pubtrust1.pdf; Tyler, *Does the American Public Accept the Rule of Law*, *supra* note 202, at 665. See generally Nancy A. Welsh & Andrea Kupfer Schneider, *The Thoughtful Integration of Mediation into Bilateral Investment Treaty Arbitration*, 18 HARV. NEGOT. L. REV. 71, 95–105 (2013); Welsh, Stienstra & McAdoo, *supra* note 200, at 65–69; Nancy A. Welsh, *Perceptions of Fairness*, in THE NEGOTIATOR'S FIELDBOOK 165 (Andrea Kupfer Schneider & Christopher Honeyman eds., 2006); Nancy A. Welsh, *Stepping Back through the Looking Glass: Real Conversations with Real Disputants about the Place, Value and Meaning of Mediation*, 19 OHIO ST. J. DISP. RESOL. 573 (2004); Nancy A. Welsh, *Disputants' Decision Control in Court-Connected Mediation: A Hollow Promise[,] Without Procedural Justice*, 2002 J. DISP. RESOL. 179 (2002); Nancy A. Welsh, *Making Deals in Court-Connected Mediation: What's Justice Got To Do With It?*, 79 WASH. U. L.Q. 787, 817–30 (2001).

204. See *infra* Part V.3.

perceive decision-making processes and dispute resolution processes as procedurally fair:

- **Voice.** First and most important, people must perceive that they had the opportunity to express what was important to them, or had voice.²⁰⁵ The more that people perceive they had the opportunity to express what was important to them, the more they perceive the process as fair. Voice is not necessarily the same thing as participation or direct engagement in the give-and-take of negotiation. Indeed, people's perceptions of their level of participation or direct engagement in negotiation have less effect than simple voice on their procedural justice perceptions.²⁰⁶
- **Respectful treatment from the decision maker.** Second, people must perceive that they were treated in a respectful and dignified manner.²⁰⁷

205. See LIND & TYLER, *supra* note 200, at 211–12; Lind, *supra* note 200, at 180; Tyler, *Social Justice: Outcome and Procedure*, *supra* note 201, at 121 (describing voice as the opportunity for people to present their “suggestions” or “arguments about what should be done to resolve a problem or conflict” or “sharing the discussion over the issues involved in their problem or conflict” and also noting that voice effects have been found even when people know they will have little or no influence on decision makers); Robert J. MacCoun, *Voice, Control, and Belonging: The Double-Edged Sword of Procedural Fairness*, 1 ANN. REV. L. SOC. SCI. 171, (2005); Nourit Zimerman & Tom R. Tyler, *Between Access to Counsel and Access to Justice: A Psychological Perspective*, 37 FORDHAM URB. L.J. 473, 488 (2010) (reporting that voice “shapes evaluations about neutrality, trust, and respect” and has the “strongest influence, followed respectively by neutrality, trust, and respect”). It should be noted, however, that people are also aware of their vulnerability to manipulation, and if they perceive evidence of unfair treatment or perceive “false representations of fair treatment,” they respond with “extremely negative reactions.” See Lind, *supra* note 200, at 187; see also Tom R. Tyler, Kenneth A. Rasinski & Nancy Spodick, *Influence of Voice on Satisfaction with Leaders: Exploring the Meaning of Process Control*, 48 J. PERSONALITY & SOC. PSYCHOL. 72, 73–74 (1985) (explaining that under certain conditions, voice without decision control heightens feelings of procedural injustice and dissatisfaction with leaders, a result described as the “frustration effect.”).

206. See Roselle L. Wissler, *Representation in Mediation: What We Know from Empirical Research*, 37 FORDHAM URB. L.J. 419, 447–52 (2010) (distinguishing between clients' direct participation and indirect participation as their lawyers negotiated on their behalf); see also Roselle L. Wissler, *Party Participation and Voice in Mediation*, 18 DISP. RESOL. MAG. 20 (2011).

207. See Tom R. Tyler, *The Psychology of Procedural Justice: A Test of the Group-Value Model*, 57 J. PERSONALITY & SOC. PSYCHOL. 830 at 831 (1989); E. Allen Lind et al., *In the Eye of the Beholder: Tort Litigants' Evaluations of Their Experiences in the Civil Justice System*, 24 LAW & SOC'Y REV. 953, 958 (1990); Tyler, *Social Justice: Outcome and Procedure*, *supra*

- **Even-handed treatment, neutrality of forum.** Third, people must perceive that they were treated in an even-handed manner, and that the forum was neutral—or at least not predisposed against them. This element can be understood in both structural and interactional (or even relational) terms. In terms of structure, people need to perceive that the role of the decision maker or dispute resolution forum is to make decisions or resolve disputes by applying fair and objective standards. In terms of interaction, people also need to perceive that the particular decision maker actually tried to be open-minded and treat their arguments in the same manner as others' arguments were treated, even if specific outcomes differed.²⁰⁸ Tom Tyler has asserted that people watch for “cues that communicate information about the intentions and character”²⁰⁹ of the decision maker—cues, for example, that the decision maker has tried to apply objective standards carefully, fairly, and in a well-meaning manner, based on relevant and objective factors.²¹⁰

note 201, at 122; Hollander-Blumoff, *Just Negotiation*, *infra* note 221, at 419–20. While respectful treatment is described here as an essential element of procedural justice, it has also been described as an element of interactional justice, and even of distributive justice. See Robert J. Bies, *Are Procedural Justice and Interactional Justice Conceptually Distinct?*, in *HANDBOOK OF ORGANIZATIONAL JUSTICE* 85 (Jerald Greenberg & Jason A. Colquitt eds., 2005).

208. See Tyler, *Does the American Public Accept the Rule of Law?*, *supra* note 202, at 664 (“Transparency and openness foster the belief that decision-making procedures are neutral.”); see also Steven L. Blader & Tom R. Tyler, *A Four-Component Model of Procedural Justice: Defining the Meaning of a “Fair” Process*, 29 *PERSONALITY & SOC. PSYCHOL. BULL.* 747 (2003) (distinguishing between “formal” or “structural” aspects of groups that influence perceptions of process fairness, such as group rules, and the “informal” influences that result from an individual authority’s actual implementation of the rules).

209. Tyler, *Does the American Public Accept the Rule of Law?*, *supra* note 202, at 664.

210. Tyler, *Social Justice: Outcome and Procedure*, *supra* note 201, at 122; see also Tyler, *Psychological Models of the Justice Motive*, *supra* note 202, at 853–54; Tom R. Tyler, *Conditions Leading to Value-Expressive Effects in Judgments of Procedural Justice: A Test of Four Models*, 52 *J. PERSONALITY & SOC. PSYCHOL.* 333, 337 (1987).

- **Trustworthy consideration from the decision maker.** There is substantial overlap between the former element and this fourth element. People seek cognitive reassurance that the decision maker has heard and accurately understood²¹¹ what they said. People also seek relational reassurance that the decision maker sincerely considered what they said and that they can trust the decision maker.²¹²

Both cognitive and relational theories explain the influence of procedural justice. Cognitively, people want to be reassured that decision makers will be fully informed before coming to their decisions.²¹³ Provision of the opportunity for voice, the demonstration of understanding, and even-handed treatment in a neutral forum respond to this desire. Research indicates, however, that people are influenced by procedural fairness even when they have been told that their voice will *not* influence the outcome.²¹⁴ Thus, procedural justice researchers now theorize that procedural fairness serves as a fairness “heuristic.”²¹⁵ Though heuristics generally are useful and well

211. See Lind, *supra* note 200, at 179.

212. See D.E. Conlon et al., *Nonlinear and Nonmonotonic Effects of Outcome on Procedural and Distributive Fairness Judgments*, 19 J. APPLIED SOC. PSYCHOL. 1083, 1095 (1989). Note that trust is itself a nuanced concept. For example, efficient commercial relations rely on “calculus-based” trust, the reliable delivery of promised or desirable behaviors, based on an instrumental cost-benefit analysis. Alternatively, trust may be “identification-based,” with such complete identification, understanding, and appreciation that one person can act for the other. See ROY J. LEWICKI ET AL., *NEGOTIATION* 288 (5th ed. 2005); see also Hollander-Blumoff & Tyler, *infra* note 219, at 494; Tyler, *Does the American Public Accept the Rule of Law?*, *supra* note 202, at 671 (noting that research demonstrates that people’s inferences about legal authorities’ trustworthiness are central to their reactions).

213. This is called “instrumental” or “social exchange” theory. See Lind, *supra* note 200, at 179.

214. *Id.* at 180–81.

215. See E. Allan Lind et al., *Individual and Corporate Dispute Resolution: Using Procedural Fairness as a Decision Heuristic*, 38 ADMIN. SCI. Q. 224, 225 (1993) (reporting researchers found that procedural justice judgments strongly influenced litigants’ decisions about whether or not to accept nonbinding arbitration awards, regardless of whether litigants were individuals, small business owners, or corporate officers; only corporate employees demonstrated no link between their procedural justice judgments and their decisions to accept awards); see also Rebecca Hollander-Blumoff, *The Psychology of Procedural Justice in the Federal Courts*, 63 HASTINGS L.J. 127, 137 (2011) (citing Kees van den Bos et al., *How Do I Judge My Outcome When I Do Not Know the Outcome of Others? The Psychology of the Fair Process Effect*, 72 J. PERSONALITY & SOC. PSYCHOL. 1034, 1034 (1997)); MacCoun, *supra* note 205, at 171, 185–86 (describing fairness heuristic theory).

grounded, their effectiveness also can reveal the workings of cognitive bias.²¹⁶

From a relational perspective, people want to know they are valued members of the social group and will be treated fairly.²¹⁷ Therefore, people also use their perceptions of procedure to assess whether they can trust decision makers and their procedures.²¹⁸ Being able to trust in this manner can help them to manage the vulnerability associated with uncertainty.²¹⁹

Applying procedural justice theory and research to Brazil's choice not to ratify the BITs, it becomes quite clear that Brazilian legislators had substantial voice during the four years spent in the ratification process. As noted *supra*, however, the nature of the treaty ratification process limited the effect their voices could have on the treaty itself. Indeed, the proposed modifications to the treaty likely would have required renegotiation. Importantly, however, the executive's

216. See Jeffrey J. Rachlinski, *Selling Heuristics*, 64 ALA. L. REV. 389 (2012) (generally examining the different views of heuristics, with some commentators focusing on the errors caused by heuristics and other commentators describing them as reflecting "ecological rationality"). See generally Amos Tversky & Daniel Kahneman, *Judgment under Uncertainty: Heuristics and Biases*, 185 SCI. 1124 (1974); HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT (Thomas Gilovich, Dale Griffin & Daniel Kahneman eds., 2002). There is a growing recognition of the extent and effects of implicit bias and unconscious bias. See, e.g., Anthony G. Greenwald & Linda Hamilton Krieger, *Implicit Bias: Scientific Foundations*, 94 CAL. L. REV. 945 (2006); Debra Lyn Bassett, *Deconstruct and Superstruct: Examining Bias across the Legal System*, 46 U.C. DAVIS L. REV. 1563 (2013).

217. See Donald E. Conlon et al., *supra* note 212; see also Tyler, *Psychological Models of the Justice Motive*, *supra* note 202, at 858.

218. See Nancy A. Welsh, *The Reputational Advantages of Demonstrating Trustworthiness: Using the Reputation Index with Law Students*, 28 NEGOTIATION. J. 1, 117 (2012); Robert K. Vischer, *Big Law and the Marginalization of Trust*, 25 GEO. J. LEGAL ETHICS 165 (2012).

219. See Rebecca Hollander-Blumoff & Tom R. Tyler, *Procedural Justice in Negotiation: Procedural Fairness, Outcome Acceptance, and Integrative Potential*, LAW & SOC. INQUIRY 473, 477 (2008) (citing E. Allan Lind, *Fairness Judgments as Cognitions*, in THE JUSTICE MOTIVE IN EVERYDAY LIFE (Michael Ross & Dale T. Miller eds., 2002)); Kees van den Bos & E. Allan Lind, *Uncertainty Management by Means of Fairness Judgments*, 34 ADVANCES IN EXPERIMENTAL SOC. PSYCHOL. 1, 26–30 (2002); see also Nancy A. Welsh & Barbara Gray, *Searching for a Sense of Control: The Challenge Presented by Community Conflicts over Concentrated Animal Feeding Operations*, 10 PENN ST. ENVTL. L. REV. 295 (2002). Even though the focus of the "group value" theories is relational rather than cognitive, there is other research indicating people are indeed likely to judge in-group members more favorably and treat them better than out-group members. Therefore, relational concerns should not be understood as the opposite of cognitive concerns. Ronald J. Fisher, *Intergroup Conflict*, in THE HANDBOOK OF CONFLICT RESOLUTION 166–67 (Deutsch & Coleman eds., 2000).

response in this instance was neither heavy-handed nor manipulative, and instead created the opportunity for the emergence of alternative measures. The substance of these measures suggests that the executive and legislators listened to, and understood, each other and the most important concerns expressed by both the opponents and proponents of the BITs.

C. The Relationship between Procedural Justice and Loyalty

Although Hirschman's theory of exit, voice, and loyalty describes the effects of loyalty, it does not do much to explain how loyalty emerges. Nor does Hirschman's theory acknowledge the independent value of listening, sincere and trustworthy consideration, expressing understanding, and demonstrating respect. Hirschman's focus instead is on concrete change in response to voice.

Procedural justice research and theories regarding the importance of listening and trustworthy consideration may help to explain the emergence of loyalty. More specifically, when a state, workplace, or other organization offers trustworthy consideration, as well as even-handed and dignified treatment, the organization is responding to voice in a manner that is likely to enhance compliance and perceptions of legitimacy.²²⁰ These, logically, should also enhance loyalty. They may even encourage further voice. Such voice and consideration have been found to be correlated with increased trust, enhanced information sharing, and a greater likelihood of developing responsive integrative solutions,²²¹ just as occurred in Brazil. Based on procedural justice theory, however, enhanced compliance, perceptions of legitimacy, and loyalty are more likely to occur even if the organization does not provide the outcome that those expressing themselves wanted.

220. See, e.g., Andrea K. Schneider & Natalie Fleury, *There's No Place Like Home: Applying Dispute Systems Design Theory to Create a Foreclosure Mediation System*, 11 NEV. L.J. 368 (2011) (discussing the perceptions of participants in a foreclosure mediation process).

221. See Rebecca Hollander-Blumoff, *Just Negotiation*, 88 WASH. U. L. REV. 381, 416 (2010); Hollander-Blumoff & Tyler, *supra* note 219, at 473 (also observing that such behaviors do not reduce negotiators' effectiveness in arriving at beneficial distributive outcomes); Welsh, *The Reputational Advantages of Trustworthiness*, *supra* note 217 (proposing a mutually-supportive relationship among a cooperative negotiation style, procedurally just behaviors, perceptions of trustworthiness, and a reputation as an effective negotiator).

Of course, there are and should be limits to the occurrence of these effects. Persistent failure to respond to voice with concrete change, especially when such response is forthcoming for others who are no more (or even less) deserving, will undermine loyalty.²²² But the effects of procedural justice may help to explain why there need not always be concrete change in response to voice, provided there is trustworthy, sincere, respectful, and even-handed consideration of what has been said.

VI. CONCLUSION

When viewed from the perspective of theory and research, Brazil's decision to enact alternative legislation and constitutional provisions, rather than ratify BITs, represents a successful means to acknowledge disparate voices, avoid foreign investors' exit, and even enhance loyalty. It is only from the perspective of the negotiators of the BITs and the proponents of international arbitration that this decision might represent a failure.

Importantly, however, Brazil's choice does not represent an unqualified success. While the system of national-level constitutional and legislative protections, contractual consent to arbitration with the state, and economic investment incentives has served Brazil well over the past decade, there are certain aspects of this dynamic that can be detrimental to those foreign investors who encounter difficulties. Most strikingly, there are certain aspects of arbitration with the Brazilian Public Administration under the Brazilian Arbitration Act that do not match the neutral dispute resolution provided by a detached international forum. Automatic application of Brazilian law as the applicable substantive standard in arbitration with the state can put foreign investors at a disadvantage, due to the many protections

222. People are aware of their vulnerability to manipulation, and if they perceive evidence of unfair treatment or perceive "false representations of fair treatment," they respond with "extremely negative reactions." See Lind, *supra* note 200, at 187; see also Tyler, Rasinski & Spodick, *supra* note 205 (explaining that under certain conditions, voice without decision control heightens feelings of procedural injustice and dissatisfaction with leaders, a result described as the "frustration effect"); Robert J. MacCoun, *supra* note 205, at 171, 188-93 (describing the potential for the manipulative use of procedural justice and "false consciousness").

the Brazilian government can give itself in the legislative process.²²³ In addition, the designation of Brazil as the seat, Portuguese as the language, and Brazilian law as the applicable law severely limits the available neutrals who can sit as arbitrators in disputes against the state, especially outside of Brazil.²²⁴

Additionally, as Brazil has become a capital exporter, rather than merely an importer like many of its peers in Latin America, the Brazilian government now finds it has its own international investors to protect.²²⁵ Without BITs, Brazilian companies investing abroad are subject to the local laws of the host country, as is true for foreign entities in Brazil.²²⁶ Although Brazilian companies have engaged in very creative workarounds by incorporating in other states with favorable BITs,²²⁷ it is probably not in Brazil's interests to force its corporations to fend for themselves in this manner. Thus, there will be a need, once again, for an opportunity for voice and responsive listening, and the definition of success will continue to evolve.

223. Barbosa & Martini, *supra* note 77, at 49, 56–59. See *BG Group PLC v. Republic of Argentina*, 134 S.Ct. 1198 (2014), and *Corporacion Mexicana de Mantenimiento Integral v. Pemex-Exploracion Produccion*, 962 F. Supp. 2d 642 (S.D.N.Y. 2013) (examples of legislation adopted by signatories to BITs that investors perceived as placing them at an unfair disadvantage).

224. Barbosa & Martini, *supra* note 77, at 52.

225. See Neto, *supra* note 39, at 3–4.

226. *Id.* at 10–11.

227. See also Fernandes de Andrade & Justino de Oliveira, *supra* note 8, at 90 (urging there is not a need for Brazil to enter into BITs, pointing out the disadvantages of arbitration pursuant to BITs versus individually-negotiated contracts, and explaining the advantages of Brazil's evolving administrative structure—including more decentralized agencies, the development of quasi-independent agencies, incorporation of arbitration, and collaboration with nation-specific chambers of commerce (e.g., Brazil-Canada)).